

Message Text

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ACTION EB-07

INFO OCT-01 ISO-00 AF-08 ARA-06 EA-07 EUR-12 NEA-10 FEA-01

ERDA-05 AID-05 CEA-01 CIAE-00 CIEP-01 COME-00 DODE-00

FPC-01 H-02 INR-07 INT-05 L-03 NSAE-00 NSC-05 OMB-01

PM-04 USIA-06 SAM-01 OES-06 SP-02 SS-15 STR-04

TRSE-00 ACDA-07 /133 W

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R 170330Z AUG 76

FM AMEMBASSY JAKARTA

TO SECSTATE WASHDC 6244

INFO AMEMBASSY THE HAGUE

AMEMBASSY TOKYO

AMEMBASSY ROME

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E.O. 11652: N/A

TAGS: EMIN, ID

SUBJECT: INDONEISA - OIL AND INVESTMENT CLIMATE

1. SUMMARY: OBVIOUSLY SENSITIVE TO IMPACT ON INDONESIAN INVESTMENT CLIMATE OF RECENT OIL CONTRACT ADJUSTMENTS, MINISTER MINES SADLI SPOKE WITH REPRESENTATIVES NINE INDUSTRIAL COUNTRIES AUGUST 16 WITH AID TO EXPLAIN AND REASSURE. STRESSING BOTH "JUSTICE" OF BRINGING INDONESIAN PROFITS IN LINE WITH THOSE IN OTHER OPEC COUNTRIES AND INDONESIA'S BUDGET NEEDS, SADLI SAID OIL SITUATION UNIQUE AND NOT INTENDED SUGGEST SIMILAR INDONESIAN EFFORTS REVISE OTHER INVESTMENT CONTRACTS. INDONESIA WANTED INVESTMENT AND, EVEN OIL CONTRACTS MIGHT BE FURTHER ADJUSTED IF COMPANIES COULD DEMONSTRATE REAL HARDSHIP. IN ENSUING DISCUSSION, AMBASSADORS STRESSED IMPACT OF RETROACTIVITY, TONE OF NEGOTIATIONS, CHANGE FROM PREVIOUS STYLE, AND SUGGESTED INDONESIA HAD WORK TO DO TO REFURBISH POSITIVE IMAGE FOR PRESENT AND POTENTIAL INVESTORS. END SUMMARY.

2. IN UNUSUAL AND SIGNIFICANT MOVE, MINISTER MINES SADLI INVITED AMBASSADORS OF US, NETHERLANDS, JAPAN, ITALY, WEST GERMANY, UK, AND FRANCE, AND COUNSELORS CANADA AND AUSTRALIA TO LUNCH AUGUST 16 TO DISCUSS INVESTMENT CLIMATE FOLLOWING RECENT ADJUSTMENTS IN OIL CONTRACTS. ALSO PRESENT WERE PHILIPPINE AMBASSADOR (AS DEAN DIPLOMATIC CORPS), PRESIDENT-DIRECTOR HARYONO OF PERTAMINA AND CHAIRMAN AND VICE CHAIRMAN INVESTMENT BOARD. LUNCH FOLLOWED PRESIDENT SUHARTO'S ANNUAL SPEECH TO PARLIAMENT WHICH ALSO STRESSED IMPORTANCE OF FOREIGN INVESTMENT.

3. MINISTER SADLI BEGAN DISCUSSION BY REFERENCE TO PRESIDENT'S SPEECH, EMPHASIZING THAT IN JUST CONCLUDED NEGOTIATIONS WITH OIL COMPANIES "JUSTICE AND EQUITY" WERE MORE IMPORTANT THAN BUDGET CONSIDERATIONS ALTHOUGH HE ACKNOWLEDGED GOVERNMENT'S URGENT NEEDS FOR FUNDS "TO MEET IMPORTANT POLICY OBLIGATIONS."

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4. ACKNOWLEDGING CRITICISM, PARTICULARLY ON RETROACTIVITY QUESTION, SADLI EXPLAINED CONTACTS WITH COMPANIES HAD ACTUALLY STARTED IN NOVEMBER WITH CALTEX. PROCESS TOOK LONGER THAN INDONESIANS ANTICIPATED AND WAS CONCLUDED ONLY IN APRIL. DELAY MEANT CORRESPONDING TIME LAG IN DISCUSSION WITH PRODUCTION SHARING CONTRACTORS AND THESE CONCLUDED ONLY LAST WEEK.

5. SADLI EXPLAINED THAT LENGTH OF TIME REQUIRED IS INDICATION OF GOI WILLINGNESS TO LISTEN TO COMPANY POSITIONS. HE REFUTED IDEA THAT THERE HAD BEEN NO BARGAINING, POINTING OUT THAT ORIGINAL GOI GOAL HAD BEEN ADDITIONAL DOLLAR FROM CALTEX. CALTEX CONVINCED GOI THAT SPECIAL CONSIDERATION NECESSARY FOR MARGINAL MARKETS, SUCH AS CARIBBEAN AND US EAST COAST, SO THAT FINAL AGREEMENT GAVE GOVERNMENT ADDITIONAL EIGHTY-SIX CENTS PER BARREL, OR 280 MILLION DOLLARS IN ADDITIONAL REVENUES IN 1976. IN REACHING DECISION ON WHAT COMPANIES COULD PAY, INDONESIA MADE USE OF OUTSIDE CONSULTANTS, INCLUDING ACCOUNTANTS AND TRANSPORTATION EXPERTS. RELATIONS WITH CALTEX NOW GOOD; COMPANY IS CONTINUING TO LIFT FOR EAST COAST MARKETS AND IS MAINTAINING LEVELS OF PRODUCTION. GOI CONFIDENT THAT CALTEX WILL ALSO MAINTAIN PREVIOUS COMMITMENTS RE FUTURE INVESTMENT.

6. DISCUSSIONS WITH PRODUCTION SHARING CONTRACTORS WERE MORE DIFFICULT PROBLEM. GOVERNMENT SOUGHT TO CHANGE BOTH COST ACCOUNTING PROCEDURES AND PROFIT SPLIT. FORMER MOST IMPORTANT FOR IMMEDIATE CASH GAINS; LATTER FOR LONG-RUN REVENUES. GOVERNMENT ORIGINALLY CHOSE GOAL OF ADDITIONAL \$2.50 PER BARREL ON BASIS OF ESTIMATE OF COMPANIES' COST OF PRODUCTION. SADLI ADMITTED GOVERNMENT HAD BEEN "SOMEWHAT ARBITRARY" IN ITS ESTIMATES AND APPROACHES, BUT THIS WAS NECESSARY TO ACHIEVE DESIRED REVENUE. HE BELIEVES NEW ACCOUNTING RULES ARE WORKABLE FOR FUTURE AND THAT MARGINAL PRODUCERS MAY WELL BENEFIT FROM THEM. HE ADMITTED GOVERNMENT MORE INTERESTED IN COLLECTING FROM BIG PRODUCERS.

7. IN COURSE DISCUSSIONS WITH PRODUCTION SHARING COMPANIES, SADLI SAID GOVERNMENT GAVE WAY IN INSTITUTING SPECIAL ACCOUNTING FORMULA FOR COMPANIES WITH SMALL RESERVES. GOVERNMENT ALSO MOVED BACK FROM EARLIER REQUEST FOR TWENTY-YEAR LIMITED OFFICIAL USE

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AMORTIZATION OF EXPENSES AND AGREED TO PERMIT EXPENSING OF INTEREST ON BANK LOANS REQUIRED TO PAY GOVERNMENT. NEW PROFIT SPLIT IS ACTUALLY 89-11. SADLI EXPRESSED VIEW GOVERNMENT COULD PROBABLY NOT GET HIGHER SPLIT AND, ON BASIS FACT SEVEN COMPANIES HAVE SIGNED, HE ASSUMED COMPANIES COULD LIVE WITH THIS.

8. SADLI ADMITTED THAT DISCUSSIONS HAD BEEN TOUGH AND THAT GOVERNMENT FEARED AT ONE POINT IT MIGHT HAVE TO IMPOSE NEW CONDITIONS. GOVERNMENT FELT COMPANIES WOULD NEED TO SIGN

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IN LONG RUN BECAUSE THEY HAD TO STAY IN INDONESIA TO RECOVER PAST INVESTMENT AND THEIR EQUIPMENT IS ALREADY HERE. GOVERNMENT ACKNOWLEDGES, HOWEVER, THAT IMPORTANT ELEMENT IS WHETHER CLIMATE IS SUCH THAT EXPLORATION AND INVESTMENT WILL CONTINUE.

9. HE ACKNOWLEDGED THAT SUDDEN REQUIREMENT FOR 300 MILLION DOLLARS IN CASH FROM PRODUCTION SHARING COMPANIES WILL GRAVELY AFFECT THEIR CURRENT BUDGETS AND WILL REQUIRE TEMPORARY REDUCTION IN EXPLORATION. HE EXPRESSED CONFIDENCE THAT EXPLORATION INVESTMENT WILL RETURN ULTIMATELY TO ANTICIPATED LEVELS. GOVERNMENT ALSO URGING COMPANIES TO BORROW FROM BANKS FOR FUTURE EXPLORATION ALTHOUGH SADLI ACKNOWLEDGED THIS ALSO REQUIRED RESTORATION OF BANKS' CONFIDENCE IN INDONESIA.

10. SADLI SAID HE UNDERSTOOD NON-OIL COMPANIES WERE ALSO WORRIED. HE WANTED ALL TO KNOW THAT INDONESIA CONSIDERED OIL COMPANY PROBLEMS SPECIAL BECAUSE GOI WAS LATE IN ADJUSTING PROFIT MARGIN TO BRING IT IN LINE WITH OTHER OPEC COUNTRIES. IT WAS NOT GOI'S INTENTION TO SEEK CHANGES IN CONTRACTS WITH OTHER MINING AND MANUFACTURING INVESTMENTS. EVEN WITH OIL COMPANIES HE SAID GOVERNMENT DESIRES CONTINUE DISCUSSION AND IF COMPANIES CAN PROVE SERIOUS PROBLEMS, GOI WILL MAKE ADJUSTMENT. HE ACKNOWLEDGED THAT SUCH ADJUSTMENTS LIMITED BY INDONESIAN POLITICAL FACTS AND WERE DIFFICULT BECAUSE OF DEGREE OF BLUFF ON BOTH SIDES.

11. FOLLOWING SADLI'S COMMENTS, AMBASSADORS PRESENT EXPRESSED IN VARIOUS WAYS CONCERN OF THEIR INVESTORS OVER CURRENT CLIMATE IN INDONESIA. NETHERLANDS AMBASSADOR JALINK SAID ROYAL DUTCH SHELL DISTURBED BY RECENT DEVELOPMENTS AND QUESTIONING WHETHER TO PROCEED WITH HEAVY INVESTMENT IN COAL. NETHERLANDS GOVERNMENT CONCERNED ALSO THAT SLOWDOWN IN OIL INVESTMENT COULD BRING BALANCE OF PAYMENTS PROBLEM.

12. AMBASSADOR NEWSOM REVEALED CONCERN OF AMERICAN COMPANIES OVER STYLE OF RECENT DISCUSSIONS. HE TOLD SADLI USG COULD BE ONLY PARTLY EFFECTIVE IN CONVEYING ASSURANCES

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OF GOI REGARDING FUTURE AND URGED THAT HIGH LEVEL INDONESIANS SEEK DIRECT CONTACT WITH EXECUTIVES OF AMERICAN COMPANIES INVOLVED. BOTH SADLI AND HARYONO SAID THEY UNDERSTOOD THIS POINT AND THEY WOULD SEEK TO REPAIR "DAMAGE." HARYONO STRESSED THAT DOOR IS NEVER CLOSED FOR FURTHER DISCUSSIONS.

13. JAPANESE AMBASSADOR SUNOBE SAID JAPANESE GOVERNMENT LINKED RECENT OIL DISCUSSIONS WITH INDONESIAN STAND ON ISSUES AT NAIROBI. HE ALSO ASKED BY JAPANESE WHETHER INDONESIANS CHANGING TO MORE NATIONALIST STANCE. SADLI ACKNOWLEDGED THERE HAD BEEN AN INDONESIAN SHIFT TO MORE ACTIVE ROLE IN ECONOMIC PRESSURES OF DEVELOPING COUNTRIES, BUT STRESSED THAT THIS DID NOT CHANGE INDONESIA'S NEED FOR AND DESIRE FOR INVESTMENT.

14. BRITISH AMBASSADOR FORD ALSO COMMENTED ON EFFECT IN LONDON OF INDONESIAN RHETORIC ON INTERNATIONAL ECONOMIC ISSUES. HE REPORTED THAT BRITISH GOVERNMENT IS CURRENTLY REVIEWING EXPORT CREDIT LIMITATION INTO MID-1980'S AND THAT FOLLOWING RECENT OIL DISCUSSIONS ITS PROJECTIONS ON INDONESIA ARE "VERY GLOOMY." AMBASSADOR FORD SAID THAT UK HAD ALSO SOUGHT TO GAIN MORE REVENUE FROM OIL COMPANIES ONLY TO FIND THAT IT CAUSED SERIOUS DROP IN EXPLORATION. FORD SAID UK HURT NOT ONLY BY DROP IN INVESTMENT BUT BY LAY-OFF OF LOCAL DRILLING CREWS BEFORE THEY HAD ACHIEVED COMPETENCE TO WORK ON THEIR OWN.

15. IN CONCLUDING SESSION, SADLI ACKNOWLEDGED PROBLEMS WHICH AMBASSADOR HAD RAISED BUT SAID THAT GOI NOT WORRIED IN LONG RUN. RECENT SWITCH IN POLICY MAY LOSE ONE OR TWO YEARS. IF, IN LONG RUN, INDONESIA COMES TO REALIZE IT HAS GONE TOO FAR, THEN CONCEIVABLY GOVERNMENT COULD STEP IN TO STIMULATE FURTHER EXPLORATION. MOTIVATION FOR RECENT CHANGES MAY HAVE BEEN PARTLY IDEOLOGICAL, BUT IN FINAL ANALYSIS INDONESIANS ARE PRAGMATIC.

16. COMMENT: SESSION MADE CLEAR THAT GOI HAS RECEIVED FROM NUMEROUS SOURCES INDICATIONS OF SERIOUS IMPACT ON CONFIDENCE OF STYLE AND CONTENT OF RECENT NEGOTIATIONS. SADLI'S EXPLANATION STILL LEAVES ROOM FOR QUESTIONS AND DOUBTS, ALTHOUGH HIS CATEGORICAL ASSURANCES REGARDING STABILITY OF NON-OIL LIMITED OFFICIAL USE

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CONTRACTS ARE PROBABLY VALID. FUTURE OF OIL RELATIONS WILL NOW DEPEND ON DEGREE TO WHICH GOVERNMENT IS ABLE TO ESTABLISH CONFIDENCE THROUGH DIRECT CONTACTS WITH COMPANIES AND ON DEGREE OF FLEXIBILITY GOVERNMENT SHOWS IN DISCUSSIONS OF ANY AGREEMENTS WHICH WILL OPEN IN OCTOBER.
NEWSOM

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